Financial Literacy

3 Core CE for NJ Realtors

Course Format and Goals

- 1 hr. and 15 min.
- 10 min. break
- 1 hr. and 15 min.
- The goal of this seminar is to improve awareness about several broad topics related to personal finance. This presentation is by no means complete. This seminar seeks to provide basic knowledge. Some of the information may seem elementary, while other subject areas may require you to pursue additional resources.
- Questions to clarify or expand upon the material are always encouraged. However, refrain from questions that are specific or personal in nature. Individuals with specific questions can request a personal appointment.
- I frequently wear multiple "hats;" however, I am not an attorney, accountant, behavioral therapist, or spiritual leader.

Few American Workers are Financially Prepared

- How long could you afford to be without a paycheck?
- Do you save any of your annual income?
  - **48% of U.S. families don't.**
- Retirement savings?
  - **One-third of us have none.**
- 68% of Americans would find it very difficult or somewhat difficult to meet their current financial obligations if their next paycheck were delayed for one week.
- 65% of working Americans say they could not cover normal living expenses even for a year if their employment income was lost.
- 38% could not pay their bills for more than 3 months.

- *Source: Council for Disability Awareness, July 2012*

Module One: Back to Basics

- *People Don't Plan to Fail, They Fail to Plan*

Goal Setting

- Must Be:

  - Realistic
  - Achievable (Time Bound)
  - Measurable

- Examples:

  - Down Payment on a home or car
  - College education
  - Eliminate Credit Card Balance
  - Retirement

- Prioritize goals by understanding “trade-offs”
- You can get loans for most things, but you can’t get a loan for retirement!

Today Money v. Tomorrow Money

Align Accounts with Appropriate Goals

- Emergency Savings (3 – 6 months *after* tax income minimum)

  Discipline yourself to use this money for real emergencies (e.g., car repairs, broken appliances, sickness, etc.).

Short Term (< 1 yr.)

- Checking Account (Operating Fund)

  Avoid comingling personal and professional funds

- Traditional Savings Account (Planned expenses that are periodic like gifts, insurance payments, taxes, etc.)

  - *Concept Check: You will need the money, so put a little away each month. Don't rely on your tax return or future commission.*

Align Accounts with Appropriate Goals

- Medium-Term (2- 5 yrs.)
  - Down payment on home, new car, etc.
- Long-Term (10 plus yrs.)
  - Education
  - Retirement

- *Concept Check*: Properly align these goals with the appropriate investment in order to achieve your goal and reduce risk!

Concept Check

- Worked with a 32 Yr. Old couple from Jersey City. They lived in a small apartment. They owned one car. Total **gross** household income of $50K.
- Goal: Down payment on a house <u>and</u> plan for a child both within the next five years.
- How much does a house in this area cost? $250K. Down Payment of 10% is $25K. How much can you save a month toward your goal? $100/month (250 Months or 21 yrs. to achieve the goal.)

- *What advice would you give them?*

A Gallup Poll found only about 1/3 of Americans (32%) maintain a household budget

↓

Only 30% of Americans have a long-term financial plan that includes savings and investment goals

↓

You’re mostly likely to budget if you make at least $75,000 per year

How many Americans actually keep a formal budget?

Budgeting

- Develop a <u>written</u> spending plan or Budget that includes <u>all</u> spending and saving.
- income = <u>savings</u> + expenses
- Commit to tracking spending for 3 Months…Be honest with yourself. You will be amazed!
- If your income is periodic (i.e., real estate commissions) you need to adopt a cash management plan
    - *Concept Check: Pay yourself First! Implement “automated” savings methods (i.e., IRA, SEP, Simple).*

Budgeting

- Most people forget to include occasional or periodic expenses
  - These expenses are inevitable so plan…

  - Appliance repair or replacement,
  - Typical expenses associated with car ownership (state inspection, routing maintenance, etc.)
  - Membership Dues
  - Children's Activities (dance outfits, karate bag, gifts for <u>other</u> kid's parties)
  - Eating Out (Routine or Special Occasion?)
  - Medical Expenses (premium payment, Rx, Co-pays, deductible)

- <u>Misc. should be no more than 10% of your budget!</u>

- Use Averages for Routine expenses (i.e., utilities, gas, tolls, parking, etc.)

Budgeting

If, after budgeting, you have a surplus put it in savings/investing.

- This helps you from living beyond your means and be prepared for unexpected expenses!

Monitoring Process

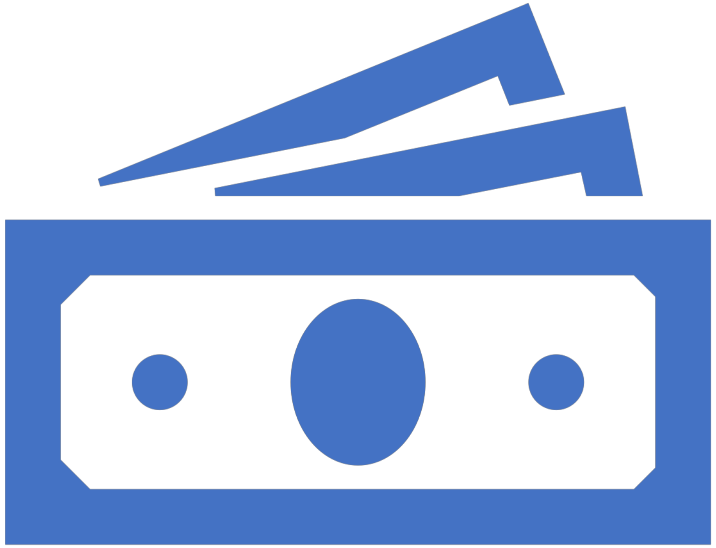
- Set and monitor goals (e.g., a child's college education)
- Monitor progress from year to year (e.g., increase savings)
- Identify problems (e.g., a high debt-to-income ratio)
- Craft solutions to problems (e.g., reducing household expenses)
- Identify needed action (e.g., purchasing life insurance)

Don’t Be Another Statistic !

2017 MarketWatch Survey

- 19% of Americans have $0 saved to cover an emergency expense
- 31% of us have less than $500 in emergency savings

Module 2: Debt



Fast Facts

- 25% of workers are unable to make ends meet every month in 2016
- 20% percent have missed payment on some smaller bills
- 71% of all workers say they're in debt in 2016 (up from 68% in 2015)
- 46% percent say their debt is manageable
- 56% say they feel they will always be in debt

Note: **June 2017 Career Builder Survey*

What's the Difference?

Good Debt v. Bad Debt

- Purpose of Loan
- Interest Rate
- Duration
- Tax Advantaged

<u>Secured Loan</u>

- Mortgage
- Car Loan
- Home Equity Line of Credit

<u>Unsecured Loan(Consumer Debt)</u>

- Credit card
- Personal line of credit
- Student Loan

Debt Ratio

- Debt Ratio is *Debt/Income*
- Gross Income v. Net Income
- If your *consumer debt* ratio exceeds 15–20% *net income* this is an indication that you are becoming over extended
  - $350 of monthly consumer debt with a $2,200 monthly net income = a 16% debt ratio or (350 ÷ 2,200) x 100

Credit Score

- Periodically check your credit report. *It's Free!*
- Three major credit bureaus (Experian, Equifax and TransUnion).
- Your score may differ slightly among the credit bureaus. If you find erroneous information, or large discrepancies request a correction in writing.

<u>Understand How Your Credit Score Is Determined</u>

- Your credit score or *FICO* score provides a snapshot of your credit status.
    - Fair Isaac Corporation compiles the score using a proprietary (non-public) formula. Here is an *estimate* about how each factor is weighted:
- Payment history: 35% of your score. (Will improve your score the fastest!)
- Amounts owed: 30% of your score. (Debt to Income Ratio)
- Length of credit history: 15% of your score. The longer you've had credit, the better.
- New credit: 10% of your score. Your credit score may go down for a short time with each new debt.
- Types of credit used: 10% of your score. A good credit mix will improve a credit score.

Consumer (Bad) Debt Elimination

It's possible to eliminate your consumer debt, but only if you don't add more!

Snow Ball Effect

- Identify account with smallest balance regardless of interest rate
- Make the minimum payment on all accounts
- As each balance is paid off add this amount to the next account

Debt Stacking

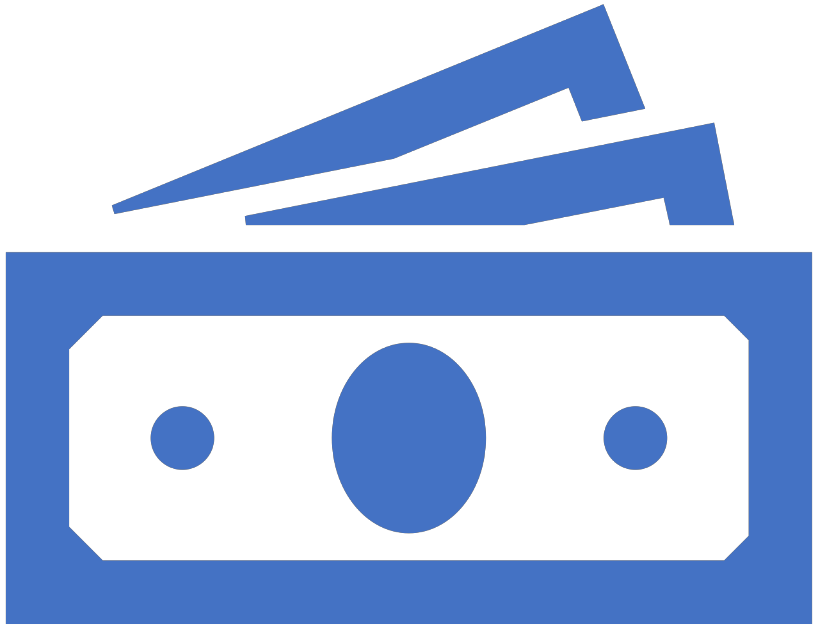
- Identify and rank accounts by the interest rate (highest to lowest)
- Make the minimum payment on all accounts
- As each balance is paid off add this amount to the next account

Debt Stacking Illustrated

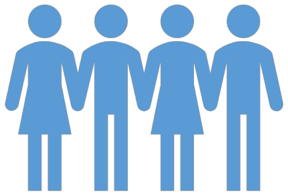
Retail Card 1 $220	**Retail Card 1**	**Paid Off**	**Paid Off**	**Paid Off**	**Paid Off**
Credit Card 2 $353	Credit Card 2 $573	Paid Off	Paid Off	Paid Off	Paid Off
Car Loan $551	Car Loan $551	Car Loan $1124	Paid Off	Paid Off	Paid Off
Credit Card 1 $303	Credit Card 1 $303	Credit Card 1 $303	Credit Card 1 $1427	Credit Card 1 $1427	Invest $1427
Mortgage $1,293	Mortgage $1,293	Mortgage $1,293	Mortgage $1,293	Mortgage $1,293	Mortgage $1,293
Total $2,720	Total $2,720	Total $2,720	Total $2,720	Total $2,720	Total $2,720

	Without Debt Stacking	*With Debt Stacking*
Payoff	23 years	9 Years (14 Years Sooner)
Interest Avoided	$0	$130,643
Interest Paid	$214,442	$83,799
Monthly Payments	$2,720	$2,720

Module 3: Income Protection



Health Insurance



Private

Health Care Exchanges (Individual or Family)

Employer Sponsored (Group)

Government Sponsored

Medicare

Medicaid

CHiP

Know the Lingo

Premium: The amount you pay monthly for your health insurance plan. The average monthly premium in the U.S. is about $450 per person.

Deductible: The amount you pay out of pocket <u>before</u> your insurance starts paying.

- Portion of costs that you pay first. At that point, insurance starts paying a portion of or all of my costs.

Co-pay: A small fee you pay each time you use a specific service – this fee doesn't go toward meeting your deductible.

Co-insurance: Your portion of the cost <u>after the deductible</u> is met. I might have a $2,000 deductible, so I'm paying 100% of the costs until I've spent $2,000. If my plan has 20% co-insurance, it means the insurance company picks up 80% of the costs, and I pay the other 20% (until I hit the out-of-pocket maximum amount).

Out-of-Pocket Maximum: This is the most you'll pay toward your healthcare in a given year. Once you've reached that amount, the insurance company picks up 100% of the costs for the rest of the plan year - excluding co-pays.

In-Network: This is your insurance company's approved list of doctors or providers. They've negotiated lower costs with these doctors.

Out–of–Network: These are doctors or providers that aren't on your insurance company's approved list. If you choose one of these doctors you'll pay more.

Concept Check

Which Plan is Better? Why?

1. The patient pays nothing out of pocket.
2. The patient pays 25% out of pocket for the first $1000.
3. The patient pays 50% of the first $2000.
4. The patient pays 95% of the first $1053.

Health Care Insurance Basics

<u>Traditional Insurance Plan</u>

- A health insurance plan with higher monthly premiums and little to no deductible.
- Best for people whose medical condition requires high utilization of the healthcare system.

<u>HDHP/CDHP – High Deductible Health Plan/Consumer Directed Health Plan</u>

- A health insurance plan with lower monthly premiums and higher deductibles (up to 50% less than traditional insurance).
- Suited for people who are healthy or don't use and don't plan to use the healthcare system often. Sometimes referred to as a "Catastrophic Plan."
- A CDHP can provide more value by pairing it with a Health Savings Account.

Health Related Savings Accounts

Health Savings Accounts (HSAs)

- Pre-tax dollar contributed to account
- Require a high-deductible policy (CDHP)
- Unused funds roll-over each year
- Plan is portable

Health Reimbursement Accounts (HRAs)

- Require a high-deductible policies (CDHP)
- Funded solely by employer
- Unused funds carried over to next year
- Funds forfeited if you leave employer

Flexible Spending Accounts (FSAs)

- Organized by employers for the benefit of employees
- Workers contribute pre-tax dollars
- Unused funds forfeited at year-end

Disability Protection

It Happens More Than You Think…

- Just over 1 in 4 of today's 20-year-olds will become disabled before they retire.
- Over 37 million Americans are classified as disabled; about 12% of the total population. More than 50% of those disabled Americans are in their working years, from 18-64.
- Less than 5% of disabling accidents and illnesses are work related, which means 95% are not -meaning Workers' Compensation *doesn't cover it..*

Think Social Security or Workers' Compensation will cover it?

- Not so much….
- 65% of initial SSDI claim applications were denied in 2012.3
- Can your family live on $1,130 a month?
- That's the average monthly benefit paid by Social Security Disability Insurance (SSDI) at the end of 2012.

**www.disabilitycanhappen.org*

Life Insurance

Common reasons to buy life insurance

- Pay off a mortgage or debts
- Lump-sum endowments for children
- Provide an education or income for children
- Make charitable donations
- Provide retirement income for beneficiary
- Pay estate and gift taxes (business owners)

Premium is based on simple variables

- Age at application
- Estimated Life Expectancy (Mortality Tables)
- Current Health and Family Medical History
- Face Amount of policy
- Duration of Policy

- Additional Fees or Riders (Covered Children, Waiver of Premium, Terminal Benefit, Policy Fee, etc.)

Common Types of Life Insurance

Whole-Life Insurance (or Cash Value)

- So-called “permanent insurance”
- Pay the premium as long as you live
- Accumulates a cash value you can borrow against
  - *Look carefully at the rate of return your money earns. Usually less than inflation (3%).*

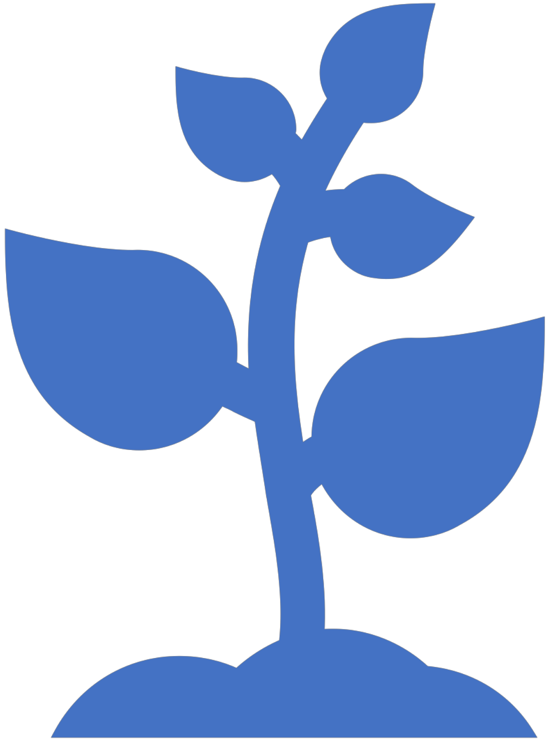
- o Variable Life Policy- Fixed premiums; investment accounts
- o Adjustable Life Policy - Can change coverage with needs
- o Universal Life- Can change premium, time period, benefit

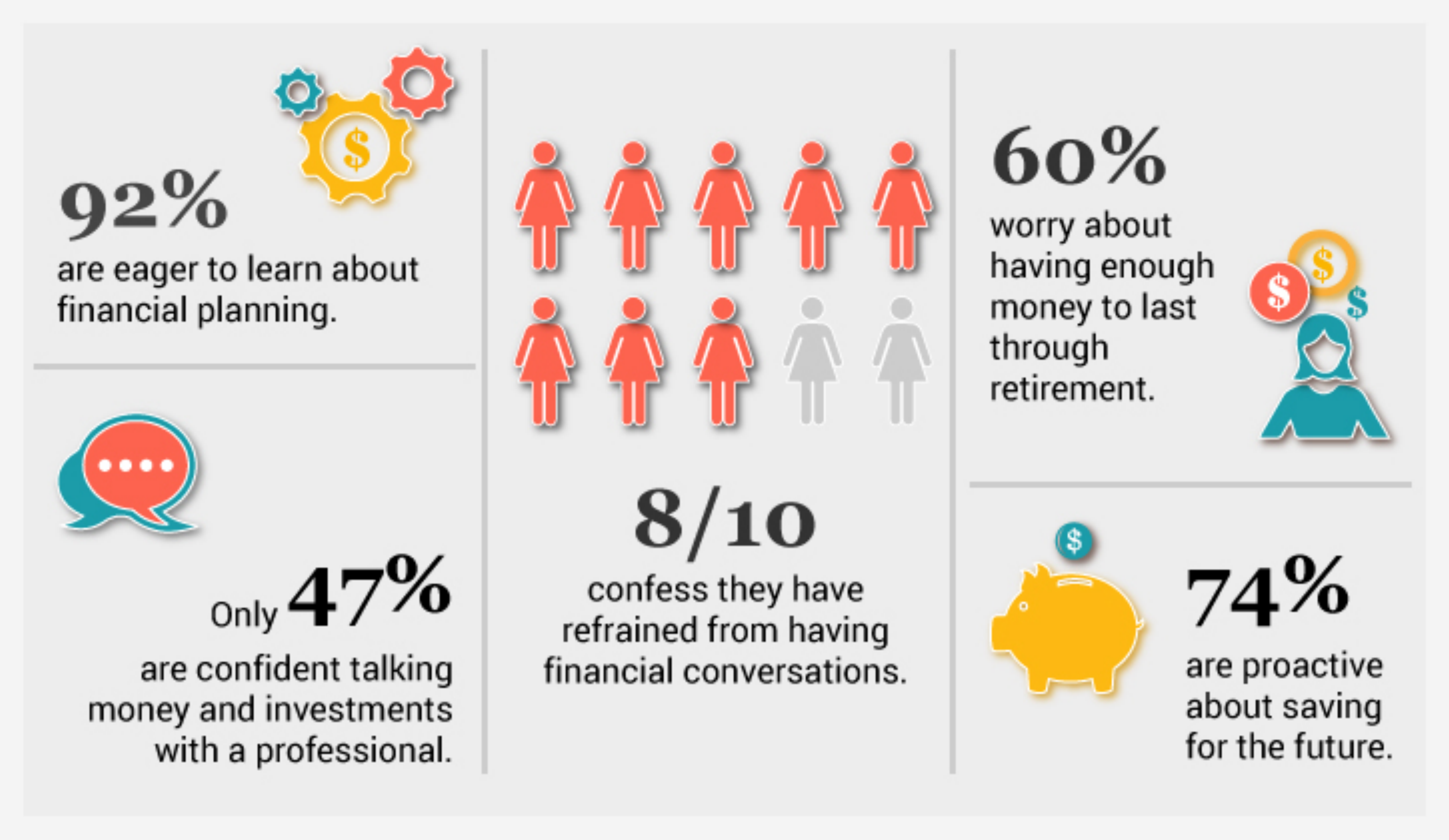
- *The premium is higher than the actual cost of the insurance. A small portion of the excess premium is held in reserve as the policy’s cash value. However, most policies accrue No Cash Value for the first several years!*

Common Types of Life Insurance

- **Term Life**
  - Protection for a specified amount, for a defined period of time… It's that Simple.
  - Most Practical and Cost Effective
  - At the end of term, the policy ends
- *Life Insurance is Not Form of Portfolio Diversification!*

Module 4: Saving and Investing




92%
are eager to learn about financial planning.
8/10
confess they have refrained from having financial conversations.
60%
worry about having enough money to last through retirement.
Only 47%
are confident talking money and investments with a professional.
74%
are proactive about saving for the future.

Inflation
or Why Everything Cost More

$50 of groceries today

Potatoes	**$3.20**
Eggs	**$2.03**
Milk	**$3.85**
Cookies	**$3.64**
Bacon	**$5.57**
Chicken	**$5.28**
Bread	$1.92
OJ	$2.65
Lettuce	$1.95
Bananas	$0.59
Coffee	$4.71
Ice cream	$4.86
Ham	$4.47
Cheese	$2.44
Peanut butter	$2.74
TOTAL	$49.90

Estimate of $50 of groceries in 20 years

(assuming annual inflation rate of 3%, which is historical US average)

Potatoes $5.78
Eggs $3.67
Milk $6.95
Cookies $6.32
Bacon $10.06
Chicken $9.54

Bread $3.47
OJ $4.79

TOTAL $50.99

Lettuce
Bananas
Coffee
Ice cream
Ham
Cheese (1⁄2 lb.)
Peanut butter

*U.S. Bureau of Labor and Statistics: Consumer Price Index (CPI)

Dollar Cost Averaging

- An investor invests $1,000 on the first of each month into Mutual Fund XYZ for five months. The share price of Mutual Fund XYZ on the beginning of each month was as follows:
  - Month 1 shares = $1,000 / $20 = 50
  - Month 2 shares = $1,000 / $16 = 62.5
  - Month 3 shares = $1,000 / $12 = 83.33
  - Month 4 shares = $1,000 / $17 = 58.82
  - Month 5 shares = $1,000 / $23 = 43.48
- The total number of shares is 298.13 and the average price paid for each of those shares is $16.77.
- The current share price is $23, which means the original investment of $5,000 has turned into $6,856.99.
- Concept Check: How does this strategy benefit the investor?

Compound Interest
RULE OF 72

- IT'S A -
MONEY
THING™

Here are some interest rates to compare—as you can see, modest increases in rates have a dramatic effect on the doubling time

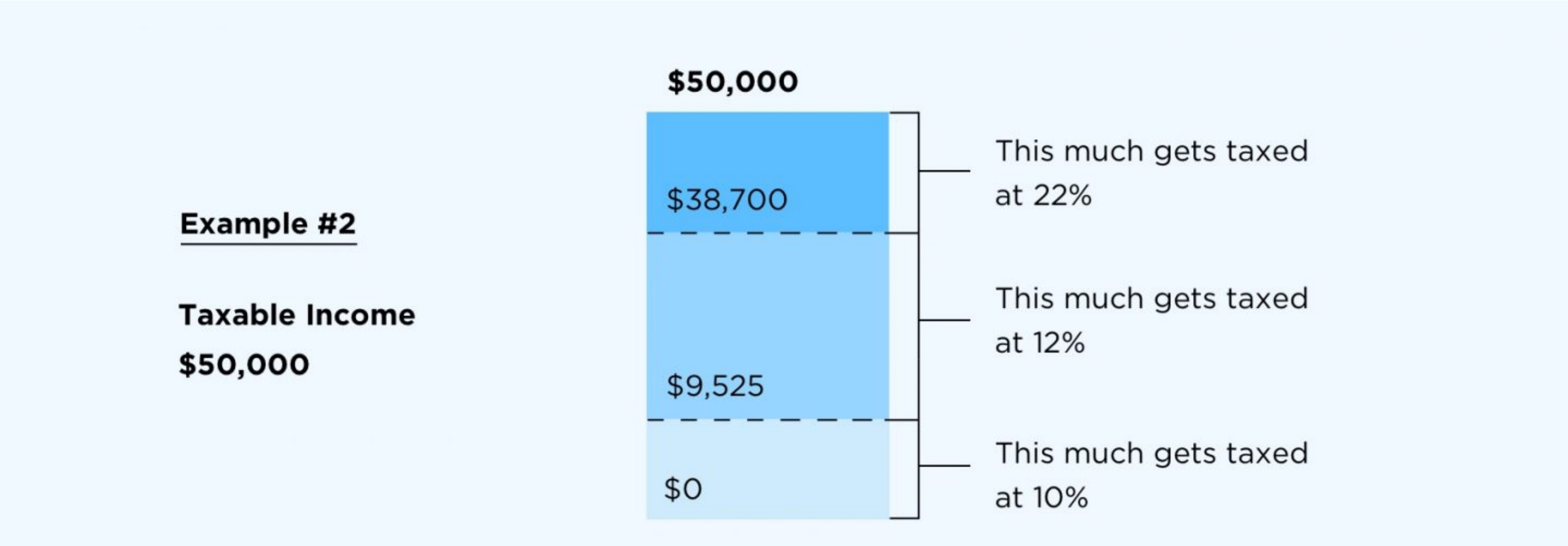
Years	1.5%	3%	6%	12%
0	$10,000	$10,000	$10,000	$10,000
6	*In times of historically low interest rates, it's especially important to start investing early*			$20,000
12			$20,000	$40,000
18				$80,000
24		$20,000	$40,000	$160,000
30				$320,000
36			$80,000	$640,000
42				$1,280,000
48	$20,000	$40,000	$160,000	$2,560,000

2018 Federal Tax Brackets

Tax rate	**Taxable Income Bracket**	**Tax Owed**
10%	$0 to $9,525	10% of taxable income
12%	$9,526 to $38,700	$952.50 plus 12% of the amount over $9,525
22%	$38,701 to $82,500	$4,453.50 plus 22% of the amount over $38,700
24%	$82,501 to $157,500	$14,089.50 plus 24% of the amount over $82,500
32%	$157,501 to $200,000	$32,089.50 plus 32% of the amount over $157,500
35%	$200,001 to $500,000	$45,689.50 plus 35% of the amount over $200,000
37%	$500,001 or more	$150,689.50 plus 37% of the amount over $500,000

How tax brackets work

- The US has a progressive tax system, meaning people with higher taxable incomes pay higher federal income tax rates.
- Being "in" a tax bracket doesn't mean you pay that federal income tax rate on everything you make.
- The government decides how much tax you owe by dividing your taxable income into chunks — also known as tax brackets — and each chunk gets taxed at the corresponding tax rate..
- Example: Even though you're in the 22% bracket your total bill would be about $6,900 — about 14% of your taxable income. *This is your "effective rate."*



Concept Check: WiiFM?

How to get into a lower tax bracket and pay a lower federal income tax rate?

Two common ways of reducing your tax bill are credits and deductions.

Tax credits directly reduce the amount of tax you owe; they don't affect what bracket you're in.

Tax deductions reduce how much of your income is subject to taxes by lowering taxable income by the percentage of your highest federal income tax bracket. *So if you fall into the 22% tax bracket, a $1,000 deduction saves you $220.*

In other words: **[Maximize your tax deductions]** — they can reduce your taxable income and could kick you to a lower bracket, which means you pay a lower tax rate

Saving For Your Retirement

Type	Eligibility	Contribution Limits	Distributions	Current Year Tax Treatment
SEP	Self-employed individuals or small businesses seeking flexibility to change contributions annually. Must be 21 yrs. of age; Minimum earned income.	Employer contribution up to 25% of the employee's annual compensation but not more than $53,000; employees are immediately vested in contributions.	Age 59.5 without Penalty; 10% penalty bf. Age 59.5; Minimum Distribution Amount (MDA) required at Age 70.5	Not Deductible by employee.
Simple	Self-employed individuals with	$12,500 Annual Deferral limit; option for matching contributions Additional annual catch-up contribution of $3,000 if age 50 or older	Age 59.5 without Penalty; 10% penalty bf. Age 59.5; Minimum Distribution Amount (MDA) required at Age 70.5	Pre-tax contributions may reduce employee's current taxable income
Traditional IRA	Taxable income; or a spouse with taxable compensation	$5500 Annual or 100% of compensation, whichever is less; spouses who file a joint return may each contribute up to maximum allowed; Additional $1000 "Catch-up" contribution if Age 50 or older	Age 59.5 without Penalty; 10% penalty bf. Age 59.5; Minimum Distribution Amount (MDA) required at Age 70.5	Deductibility dependent of participant modified AGI or eligibility to participate in an employer sponsored retirement plan (i.e., 401k)
Roth IRA	Taxable income; or a spouse with taxable compensation	$5500 Annual or 100% of compensation, whichever is less; spouses who file a joint return may each contribute up to maximum allowed; Additional $1000 "Catch-up" contribution if Age 50 or older	Age 59.5 without Penalty; 10% penalty before Age 59.5; No MDA	Tax Free growth and distribution of earnings (provided certain conditions are met)

Note: This information is not complete. Consult a professional tax advisor for information about your particular situation.

Getting Help to Make Sense of It All

Many people say they are "*financial advisors*" or "*financial planners,*" but they may not have a obligation to you – the client!

In fact, Brokers and other agents they may not be required to put the client's interests first. They are only obligated to provide you with "*suitable*" financial products or advice.

Fiduciary

- Registered Investment Advisors (RIA) are required by law to be fiduciaries for their clients
- Certified Financial Planners also have a professional and ethical duty to place their client's interests ahead of their own.
- An advisor must place his or her interest <u>below</u> that of the client.
- An advisor must do his or her best to make sure investment advice is made using accurate and complete information. The analysis must be as thorough as possible.
- An advisor must avoid conflicts of interest. As a fiduciary, an advisor must disclose any conflicts of interest or potential conflicts of interest.

Suitability

- The suitability standard only requires that the agent reasonably believes that a recommendation is suitable for the client, in terms of the client's financial needs, objectives and unique circumstances.
- Suitability means making sure transaction costs are not "*excessive*" or that a recommendation is not unsuitable for a client.
- The need to disclose potential conflicts of interest is not as strict a requirement as it is with a fiduciary.
- An investment or recommendation doesn't necessarily have to be consistent with the individual investor's